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JAPAN'S ECONOMIC FORECASTERS

Summary

In Japan, economic forecasts for the fiscal year are issued every December by government and private financial institutions. Confidence in these estimates has been declining recently, however, owing to the disparity between projected and real growth levels. Moreover, the drop in economic growth has created lasting large fiscal deficits and severe trade frictions. Since the oil crisis, a structural change in the Japanese economy has stymied efforts to elucidate economic activity and find solutions to sluggish growth. While recent predictions have clustered around a narrow range of growth rates, in the medium- and long-term outlook there is a great difference between economists, whose forecasts range from zero growth to as high as 6 percent.

Economic Forecasts

The extensive use of economic forecasting in Japan by government and private institutions followed the introduction of an econometric model used in the government's medium-term economic plan for FY 1964-68. Every year, more than two dozen economic projections are released by government agencies, business and financial institutions and research organizations. Generally, the picture drawn by government economists tends to be more optimistic than the private think-tank forecasts.

The predicted upturn in the government's initial forecast for FY 1982 (April 1, 1982 - March 31, 1983) was for real growth of 5.2 percent, with the domestic sector contributing 4.1 percentage points and external demand 1.1 percentage points. When the slowdown persisted, however, and it was estimated that growth would be closer to 2.7 percent unless some stimulus was provided, the government had to adopt an economic recovery package which was expected to spur growth to a 3.4-percent rate. Revisions were called for once again, though, in December when the government said the final figure would be closer to 3.1 percent.

One explanation for this juggling, it is assumed, is that because of domestic political considerations the government had to show that it would be able to cut the huge fiscal deficits. And the way it would do that was through the receipt of tax revenues based on this inflated growth rate. But since private financial and economic institutions also miscalculated, this cannot be the sole explanation. Why were all the economic forecasts for FY 1982 wrong?

For one thing, the unexpected depreciation of the yen came as a surprise. With high U.S. interest rates causing an appreciation of the dollar against the yen, prices of imported raw materials climbed. Constrained by the already-large interest-rate differential, the Bank of Japan was unable to cut the official discount rate, which would have lowered interest rates and stimulated the economy. Second, exports declined despite the yen depreciation due to the sluggish world economy and persistent trade frictions with the United States and the European Community (EC). Export figures by the Ministry of Finance (MOF) show that 1982 exports slid 8.7 percent from the previous year in the first decline since 1952. Third, not even the more liberal loan and tax policies favoring home ownership led to the hoped-for rise in housing construction. In fact, housing starts for 1982 fell 6.5 percent to 1.14 million units and officials say that 1983's level will only be 1.15 million starts. And finally, unexpectedly, an increase in real income boosted personal consumption.

In preparing its FY 1983 forecast, however, the government has tried to be more realistic. Its models foresee revitalized private domestic demand, low inflation, meager government spending and a turnaround in exports, which it expects will produce 3.4 percent growth. Domestic demand is expected to lead the modest expansion, with external demand making up only 0.6 percentage points of the total. Personal consumption is expected to increase by 3.9 percent, housing investment by 2.6 percent and private capital investment by 2.9 percent. Consumer prices are projected to rise 3.3 percent, while the increase in wholesale prices is figured at only 1.1 percent. The current account will post a $9-billion surplus. Production will increase from 1.0 percent to 4.4 percent and employment will increase slightly.

As shown in Table 2, most private financial and economic institutions share this view that moderate economic growth can be achieved in FY 1983, and have turned in estimates ranging from less than 2.0 percent to over 4 percent. The most pessimistic forecast, by Dai-Ichi Kangyo Bank, calls for 1.8-percent growth; the most optimistic outlook is the 4.1-percent pickup seen by Mitsubishi Research Institute. In general, the expectation is that the Japanese economy will remain sluggish in the first half of the fiscal year, but will begin to perk up in the latter half, given overseas economic recovery and yen appreciation induced by falling U.S. interest rates. These lower rates will facilitate a drop in interest rates in Japan because the possibility of capital outflows will no longer be such a worry. The lower interest rates, in turn, will stimulate the economy and buoy private capital spending and housing construction.

What is unclear in these forecasts is the specific leading factor for economic growth. While Mitsubishi Research Institute predicts an increase in personal consumption based on its assumption that an income-tax cut will be passed, others predict more moderate consumer spending based on small wage increases. The lower interest rates, while a factor in private capital spending and housing investment, are not expected to have much momentum; nor will the austere budget planned for 1983 stimulate the economy. On the external scene, the assumptions of an upturn in the world economy have led forecasters to suggest a faster pace for Japanese exports, but it is likely that restrictive trade practices and mounting protectionism will brake this movement.

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Government Forecasts

Economic Planning Agency (EPA) — EPA forecasters emphasize the importance of macroeconomic results, such as employment, balance of payments and inflation. They are inclined to aim at achieving higher economic growth consistent with long-term economic plans. EPA, however, must absorb the recommendations of the Ministry of Finance (MOF) and the Ministry of International Trade and Industry (MITI): the former puts more emphasis on the country's fiscal balance and therefore supports higher nominal economic growth to produce higher tax revenues; the latter focuses on the balance of trade.

An analysis of Table 1 shows government forecasts were below actual results during the years of high economic growth and above after the oil crisis of 1973. These errors are partly because government forecasts are not purely an econometric exercise, but also take aim at a policy target. That is, the government may have to use the document to lever the economy on to the right track if necessary. This is particularly characteristic of EPA, which is a coordinating agency whose officials come from other ministries. The economic forecast is also influenced by the agency's director general. For example: in FY 1974, then-EPA Minister Takeo Fukuda, a proponent of low economic growth, argued that high growth could not continue due to Japan's limited resources — and predicted that economic growth would fall to 2.5 percent. A similar motive in FY 1982 affected the economic forecast authored under the direction of then-EPA Minister Toshio Komoto, a supporter of high economic growth. At the initial stages, EPA had in mind a 4-percent level, as did a number of other private institutions. But Mr. Komoto reportedly insisted on 6 percent, which he considered necessary to resolve the country's shortfall of tax revenues, unemployment and trade frictions. In short, EPA's analysis is influenced by political factors.

Ministry of International Trade and Industry (MITI) — The role of this ministry is to induce policy measures which will stimulate the economy by exaggerating economic problems. In particular, MITI keeps an eye on the state of industry. Its economists support stimulus measures including expenditures for public works and lower discount rates when the economy turns downward. The ministry works against any increase in the discount rate (or increase in taxes, or cuts in expenditures) that might be proposed to curtail inflation when the economy turns up. Particularly in downturn phases, MITI is very active in influencing the business community to support its recommendations for policy changes. Recently, though, neither the business community nor Keidanren have sought special stimulus measures because Keidanren has tried to emphasize slimming down the bloated government. As a result, MITI's voice has been weakened.

For MITI, the movement of goods is paramount; the agency is insensitive to trade in services. The main economic indicators, MITI says, are industrial production and shipments. While reliance on these indicators was justified in the high economic growth period, the recent data show that services now carry increased weight in total business transactions.

Ministry of Finance (MOF) — Finance analysts judge the state of the economy by the fiscal balance and are concerned about nominal economic growth and tax revenues. MOF seems to pay little attention to activities on the margin of the economy, that is, trade problems caused by increasing current-account surpluses or the implications of pressing for fiscal balance when a savings surplus prevails in the private sector.

In the high economic growth period, the MOF consistently underestimated growth. Based on this low projection, it then formulated a budget that produced a surplus. This made it possible to cut income taxes and spend additional funds on programs called for

by politicians and other ministries. This technique, however, under recent conditions, implies lower tax revenues and makes it impossible to formulate a budget. Now the MOF has set higher nominal growth rates as a means of balancing the budget without resorting to bond financing. But these bloated forecasts brought shortfalls in tax revenues of ¥3.9 trillion ($138 billion) in FY 1981 and ¥4.1 trillion ($17.1 billion) in FY 1982. Even within MOF there are different allegiances: the budget bureau tends to predict high growth; while the tax bureau, which is responsible for tax revenues and tries to avoid shortages generally opts for lower figures.

Bank of Japan — For the Bank of Japan (BOJ), the first priority is stable prices. When forced to choose between economic stimulus or stable prices and stagflation, BOJ's choice is the latter, while MITI and EPA both incline toward stimulating the economy in order to raise employment. This emphasis on price stability, it should be noted, also leads BOJ to veer away from MITI's position during economic upturns, when it opposes further economic stimulation and stresses monetary restraint in the face of increasing prices. Therefore, the bank raises the official discount rate as early and quickly as possible, but cuts it late and reluctantly.

Private Forecasts

Private financial institutions, whose 1983 projections fall in a narrow range from below 2 to over 4 percent, are just as biased as the government, and until very recently, could be identified by their preferences. A comparison of business forecasts shows that banking institutions are consistently conservative, but securities companies, which were very optimistic, have been affected by the increasing importance of the bond market and the difference between expectations has been narrowed. As for individual economists, Osamu Shimomura is famous as a zero-growth supporter and Hisao Kanamori as his high-growth counterpart. Early on, Shimomura advocated high growth policies in the 1950s and supported the income doubling plan of Prime Minister Ikeda in 1960. But he turned to a zero-growth approach after the oil crisis, emphasizing the constraints energy supplies pose to the economy. Convinced that Japan will have to adjust to this pattern, he does not support stimulative policies or wage increases and regards fiscal reconstruction as essential.

On the other hand, Mr. Kanamori says that appropriate fiscal-monetary policies will keep Japan on a high-growth course and that fiscal balance can be maintained through tax cuts and public-works spending. Actual growth since the oil crisis has fallen below his estimates he says, because the government has not taken appropriate economic policies. Generally speaking, his point of view emphasizes the importance of manufacturing industries but ignores the weight of the service sector. Another leading economist, Toshihiko Yoshino, a former offical of the Bank of Japan, focuses on price movements. He cites inflation as the greatest danger and insists that economic policy has to be directed toward appreciation of the yen.

In the business community, Keidanren, the Federation of Economic Organizations, has a prominent role. Its recommendations represent the views of its member corporations and associations. Recently, Keidanren has begun to talk of a structural change in the economy, and has expressed doubts about the effects of macroeconomic policies because it says that demand for goods has already reached a saturation point. The organization would like to see the government stress individual micro measures, such as flexible application of the antitrust law to depressed industries.

The Long-Term Economic Outlook

The Japanese government's medium- and long-term economic plans are authored by the Economic Council, an advisory body which includes business executives, former

government officials and academicians. Here, too, political intervention is a strong influence. Occasionally, members will resign from the council because they are unwilling to go along with the final document. At present, a revision of the current seven-year economic plan is under way to reflect the depressed level of growth since the oil crisis.

However, there is a difference of opinion in this matter. One group sees the big drop in growth from 10 percent in the 1960s to about 3 percent after the second oil crisis as a structural change which will remain unaffected by traditional measures to boost spending and investment. Others say the current recession has been aggravated by a lack of demand as a result of the increase in income transfer to the oil-producing countries and the remedy, they say, is fiscal policy. Reduction of the debt will follow economic recovery, they argue. This debate has been joined by Finance officials, who take the structural argument, and MITI, a proponent of intervention. Observers are convinced that the Finance Ministry's motives in taking this lower position are clear; that is, higher growth can be used to justify hikes in government expenditures and tax cuts — both of which will retard efforts to balance the budget.

MITI opts for a higher 5-percent figure, and assumes that demand exists for social infrastructure, housing and personal consumption. These officials say that 5-percent growth will contribute to decreasing fiscal deficits, help resolve trade imbalances by increasing imports of manufactured goods, assure full employment and enhance economic cooperation. The political market MITI serves would profit from an expansion. The effort now is to resolve these inter-agency conflicts before the summer when the new economic outlook is scheduled to be released.

Source: "Keiki Handan" (Economic Prospects), Nihon Keizai Shimbun, Tokyo, November 1982 (in Japanese).

For further information, contact Yoshio Nakamura.

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Table 1

Economic Growth Forecasts by the Japanese Government

Fiscal Year	Projected Growth Rate	Actual Growth Rate
1965	7.5%	5.7%
1966	7.5	11.4
1967	9.0	11.1
1968	7.6	13.0
1969	9.8	12.1
1970	11.1	8.3
1971	10.1	5.3
1972	7.7	9.7
1973	10.7	5.3
1974	2.5	-0.2
1975	4.3	3.6
1976	5.6	5.1
1977	6.7	5.3
1978	7.0	5.1
1979	6.3	5.3
1980	4.8	4.5
1981	5.3	3.3
1982	5.2	3.1
1983	3.4	---

Source: Economic Planning Agency

Table 2

Forecasts for Fiscal 1983 Economic Growth by Major Research Institutions

	Government	Mitsubishi Research Institute	Daiwa Securities Research Institute	Research Institute of National Economy	Nomura Research Institute	Fuji Bank	Nikkei Research Center	Dai-Ichi Kangyo Bank
Gross National Expenditure (in real terms)	3.4%	4.1%	3.4%	3.4%	3.3%	2.8%	2.7%	1.8%
Final Private Consumption Expenditure	3.9	3.7	3.0	3.5	2.9	3.3	3.2	2.1
Private Housing Investment	2.6	2.3	5.0	4.5	2.2	2.7	-0.6	0.8
Private Equipment Investment	2.9	3.3	2.3	2.7	4.3	2.1	0.9	0.8
Private Inventory Investment	---	13.9*	1.4	4.6	17.5	30.0	14.0	-4.9
Final Government Consumption Expenditure	---	2.3	2.3	---	2.2	0.4	3.1	2.4
Public Fixed Capital Formation	---	3.6	3.2	0.8	2.6	-1.2	1.8	-0.6
Exports of Goods and Services	---	0.9	2.5	5.4	4.0	2.9	2.8	1.8
Imports of Goods and Services	---	-4.4	-0.8	1.8	3.8	1.8	1.9	-0.1
Wholesale Prices	1.1	2.2	-0.4	1.0	-0.2	0.6	-0.3	0.1
Consumer Prices	3.3	4.4	3.3	1.8	3.3	2.4	2.7	2.5
Current Account Balance (in millions of dollars)	$9,000	$14,090	$8,635	$13,800	$12,200	$9,800	$8,319	$15,000
Yen-Dollar Exchange Rate	---	---	225.93	235.00	225.00	235.00	228.75	246.30

*Includes government inventory

Source: The Oriental Economist, February 1983